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TAGS: ECON ETRD EIND EINV WTRO CH
SUBJECT: CHINA/STEEL: WRAP-UP OF SECOND SINO-UNITED STATES STEEL DIALOGUE

SUMMARY

¶1. (SBU) Summary. Chinese and United States Government delegations supported by steel industry representatives from both countries conducted the Second Sino-United States Steel Dialogue in Beijing October 19-20, 2006. The dialogue included a broad range of presentations relating to the steel industry-including overviews of bilateral and multilateral dialogues, experiences of the United States steel industry's reorganization efforts, and China's Steel Policy-from both delegations and included discussion periods relating to the presentations. The United States delegation, led by Assistant United States Trade Representative (AUSTR) Tim Stratford and Deputy Assistant Secretary (DAS) of Commerce Jamie Estrada, emphasized that the United States Government and steel industry is concerned about China's growing excess steel production capacity. If this production capacity continues to grow unabated, it will have a deleterious impact upon the world steel market. The United States delegation emphasized that if market forces were fully at play in China, such overcapacity would not exist, suggesting that the Chinese Government is subsidizing the country's steel sector.

¶2. (SBU) For its part, the Chinese delegation led by Ministry of Commerce (MOFCOM) Director General (DG) Wang Shouwen stated that China's steel sector is not subsidized. The United States must stop applying its own market experiences to China's economy. China is developing in a different fashion than the United States and this largely accounts for the differences in the two markets. DG Wang encouraged the United States to have patience with China as its steel sector reorganized. AUSTR Stratford, DAS Estrada, and DG Wang concluded the dialogue by agreeing to hold another round of talks in early 2007, possibly in the United States. DG Wang agreed to provide the United States information on the product breakdown of China's steel exports covered by the recent reductions in value-added tax (VAT) rebates and an explanation of why the rebates for some steel products were reduced but not others, a list of obsolete plants that have actually closed under the Chinese Government's steel plan and clarification by the Chinese Government

of what is correct and what is incorrect in the North American industry's China Syndrome subsidies report and United States industry's submission to USTR regarding China's World Trade Organization (WTO) compliance. Both sides agreed to exchange electronic copies of the presentations made during the talks. End Summary.

INTRODUCTORY REMARKS

¶3. (SBU) In separate introductory remarks, AUSTR Stratford and DAS Estrada began the Second Sino-United States Steel Dialogue by outlining United States Government and steel industry concerns that China's rapidly increasing steel production capacity is threatening the health of the world steel market. Chinese steel exports have been growing during the past several years and in 2005, China became a net steel exporter. AUSTR Stratford and DAS Estrada emphasized the importance of market mechanisms being allowed to work in the Chinese steel industry. The United States industry delegation is eager to share its experiences in restructuring to meet changing market conditions. The United States Government for its part wants to outline the very limited role it played in this restructuring. AUSTR Stratford said that this information should be useful to the Chinese delegation as it wrestles with how to manage growing overcapacity in the Chinese steel sector.

¶4. (SBU) MOFCOM DG Wang Shouwen stated that his goal for the dialogue is simply to resolve misunderstandings held by the United States Government and steel industry regarding the Chinese steel industry. In particular, the Chinese delegation wants to address assertions that the Chinese Government subsidizes the steel industry. DG Wang agreed with AUSTR Stratford and DAS Estrada that the Chinese Government and steel industry would benefit from

learning from the United States steel industry's restructuring experiences.

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TWO SIDES OUTLINE BILATERAL AND MULTILATERAL STEEL DIALOGUES
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5.(SBU) Joe Spetrini, Deputy Assistant Secretary of Commerce for Policy and Negotiations, provided participants an overview of the North American Steel Trade Committee (NASTC). The NASTC-made up of the Canada, Mexico, and the United States-is successful because industry plays a large part in planning the agenda and working collaboratively to make each meeting a success. DG Wang inquired if any of the three parties had initiated new dumping cases against one another since the NASTC's creation. DAS Spetrini responded that the NASTC did not preclude the filing of antidumping cases. There have not been any new petitions filed since the NASTC's inception, but antidumping orders on steel products from the three countries remain in place and are subject to administrative reviews. United States industry representatives underscored the importance of the three countries' steel companies using the NASTC to discuss matters of mutual interest to which a resolution may be found rather than arguing about issues that cannot be resolved.

¶6. (SBU) A representative from MOFCOM's Department of Foreign Trade followed this presentation with an overview of China's bilateral steel dialogues with Japan and South Korea. The Chinese Government, accompanied by Chinese steel industry representatives, has held ten meetings with Japan and eight meetings with South Korea since 2001. The Chinese Government uses these dialogues to promote stability and healthy development of steel markets in all three countries and to avoid problems in steel trade. MOFCOM explained that in both bilateral dialogues they discuss trade in raw materials and finished steel products, along with other factors of importance to steel trade. AUSTR Stratford noted recent press reports indicating the Japanese Government is willing to assist China in closing inefficient excess steel capacity and asked the Chinese side whether such assistance had been accepted. DG Wang stated that he was unaware of such an offer. Japan has offered environmental and energy experts to assist Chinese steel companies in becoming more

environmentally friendly and less-energy intensive.

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INDUSTRY DELEGATIONS EXCHANGE VIEWS ON CHINESE STEEL SECTOR
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¶7. (SBU) In separate presentations the Steel Manufacturers Association (SMA) and the American Iron and Steel Institute (AISI) underscored the importance of the United States and Chinese steel industries learning more about one another. The United States steel industry is concerned that much of the Chinese steel industry is using out-dated, environmentally harmful and energy-intensive technology, and that Chinese steel production capacity is increasing at a very high rate. AISI stated its willingness to sign a cooperation agreement with the China Iron and Steel Association (CISA) to establish a regular exchange of publicly available steel industry market statistics and to encourage more contact between the two associations. AISI raised this idea with CISA several years ago, but to date, an agreement has not been concluded.

¶8. (SBU) CISA stated that the association is interested in learning more from United States counterparts. In particular, China's steel industry hopes to learn more about advanced United States steel industry technologies through bilateral exchanges and cooperation. CISA representatives try to visit United States steel companies once a year in pursuit of this goal. The United States has a strong demand for steel and in CISA's opinion, United States steel companies are unable to produce enough to meet that demand. This creates an opportunity for Chinese steel exports to supplement United States steel production rather than undercut it. CISA concluded that there should be more face-to-face discussions between the Chinese and United States steel industries and that further interaction will help protect the market order. The China Chamber of

Commerce of Metals, Minerals, and Chemicals Importers and Exporters stated that it is willing to consider exchanging steel market data as recommended by AISI.

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UNITED STATES DELEGATION OUTLINES HISTORY, PROBLEMS WITH STEEL SUBSIDIES
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¶9. (SBU) DAS Spetrini provided a historical overview of government steel subsidies during the past several decades. Numerous countries have considered a strong steel industry to be strategically important and as a result, make policy choices that lead to global excess steel production capacity. The sale of steel products involves aggressive price competition since steel is a commodity and for certain products undifferentiated. DAS Spetrini stated that the United States and other Western Governments are concerned at present that some countries in Asia are using their banks as a policy tool to support local steel companies. The banks are issuing steel companies loans at less than market rates of interest to prop them up in the face of international market competition. This form of subsidy in the past damaged the world steel market.

¶10. (SBU) AUSTR Stratford followed this presentation with a discussion of the importance of trust in a market economy. To achieve market benefits a country or company must work together with other parties, but these relationships only work if they are based in mutual trust. In order to build trust, there must be transparency. AUSTR Stratford stated that when China does not answer its transitional review mechanism (TRM) questions or otherwise fully observe its WTO commitments, other countries begin to question China's motives. Increased transparency on these matters will assist China's transition to a market economy and make the country more prosperous.

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CHINA DEFENDS EXPORT TAX REBATE POLICY, COKE EXPORT QUOTAS
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¶11. (SBU) DG Wang and other Chinese Government representatives stated that recent changes in China's VAT export rebate policy for

certain steel products are intended to decrease environmentally harmful and energy intensive steel production. Many countries use tax rebates as an economic tool to promote or discourage exports. These rebates are not prohibited by the WTO as long as they are not more than the original tax levied, and none of the Chinese rebates exceed the amount of tax levied. A National Development and Reform Commission (NDRC) representative explained that China has three tools available to manage its economy: economic tools, legal tools, and administrative tools. Collecting or rebating taxes is a legitimate economic tool to promote or discourage exports. In this case, the Chinese Government's goal is to discourage production of certain steel product categories by limiting their export.

¶12. (SBU) Chinese representatives went on to note that coking coal quota levels will be announced soon and that they will be the same or similar as last year. The coking coal quota policy, similar to the VAT export rebate policy, is intended to discourage environmentally harmful, energy-intensive production. The NDRC said that the United States and European governments frequently complain about this policy. Despite these complaints, it is not China's responsibility to take on the world's burden of environmentally-harmful, energy-intensive natural resource production. The coking coal export quota is designed to send a message to the Chinese domestic market rather than to harm world trade. AUSTR Stratford responded that export quotas are forbidden by the WTO because they affect world market supply and prices. As a result, quotas are inappropriate domestic policy tools. The United States Government policy is that enforcement of strict environmental laws and application of stringent energy standards are the appropriate means of regulating environmentally harmful, energy intensive production.

NDRC EXPLAINS CHINA'S STEEL POLICY

¶13. (SBU) The NDRC began its explanation of its July 2005 Steel Policy by stating that while the Chinese Government may have intervened to increase capacity in the steel industry or determine where factories were built in the past, such intervention no longer takes place. The Chinese Government has determined that investments should be market-led by enterprises, banks should determine who receives credit and what the interest rate would be, and the Central Government will only intervene if macro-economic controls become necessary. The NDRC stated that as a result of these reforms, Chinese companies purchase raw materials from any country at a price they determine acceptable, set their own products' sales prices, and determine whether to export products in accordance with market considerations.

¶14. (SBU) The NDRC said that it has several aims for the Steel Policy: the steel industry should meet with growth demands of other industries; the industry should consolidate through mergers and acquisitions and companies using obsolete technology should be closed; the industrial layout of the steel industry should be altered between now and 2020; steel producers should use more environmentally-friendly technology and use less energy in production. The Chinese Government has required domestic steel producers with an annual capacity of more than 5 million metric tons to submit a plan to the Central Government outlining how these goals will be achieved. The NDRC said that the companies can implement their respective plans once approved by the Chinese Government.

¶15. (SBU) The NDRC went on to say that the Chinese Government wants to use economic tools to create several large, word-class steel companies, but will not build nw factories in order to achieve this goal. Beijing also wants to encourage steel producers that are not well placed for transportation or energy needs to relocate to other, more sustainable locations. The Chinese Government wants to encourage steel companies to invest in advanced steel-making technology, especially technology that is environmentally friendly and conserves energy. The NDRC noted that Beijing will continue to monitor the pace of exports. Beijing will use tools, such as decreasing the export VAT rebate, to ensure the domestic market has

adequate supply and that Chinese exports do not harm global market prices.

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INDUSTRY, NDRC RESPOND TO UNITED STATES DELEGATION QUESTIONS ON STEEL POLICY
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¶16. (SBU) In response to questions from United States industry delegates, several Chinese industry representatives stated their companies operate according to market principles and are not subsidized by the Chinese Government. Notably, a representative of Wuhan Iron and Steel said that his company receives bank loans with the same lending terms as other state-owned enterprises and private companies, and that it pays dividends to all owners, including the Chinese Government. The NDRC further explained that the People's Bank of China sets national interest and lending rates and with the exception of two policy banks that don't do much business with the steel industry, Chinese banks lend according to market principles.

¶17. (SBU) The NDRC ended its presentation by responding to a broad range of U.S. industry questions regarding environmental regulations, water and electricity tariff rates, and steel enterprise closures. The NDRC noted that it is publishing the names of companies that are not following environmental standards; however, it is a challenge to effectively monitor steel enterprises' compliance to these standards given China's size. The NDRC stated that Chinese steel companies pay the same electricity and water prices as other industries. The Chinese Government plans to increase electricity and water prices for companies using outdated, energy-intensive technology as an economic tool to encourage them to

adopt better production practices.

¶18. (SBU) In response to questions relating to the closure of excess steel production capacity, the NDRC acknowledged that China's steel industry has received too much investment, possesses too much obsolete capacity, and manufactures too many low-quality products. The Chinese Government wants to close steel producers employing obsolete, environmentally harmful technology, but with domestic demand for steel products so high, it is difficult to close these mills down. Furthermore, the NDRC noted that using administrative measures to close plants would cause significant labor unrest given that Beijing does not have the resources to replace the unemployed workers' wages.

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DELEGATIONS OFFER FINAL THOUGHTS, OUTLINE NEXT STEPS
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¶19. (SBU) AUSTR Stratford stated in closing that although the Chinese Government may no longer directly intervene in the market, his impression is that market forces have still not taken full root in the Chinese steel sector. China's steel industry is driven by high domestic demand for steel products and as a result, it is difficult for the Central Government to completely remove itself from the sector. AUSTR Stratford noted that China's incomplete transition to the rule of law is resulting in the country's laws and regulations, such as those intended to protect the environment, not being effectively enforced. The United States Government and industry still have a difficult time understanding China's large steel production capacity increases and how factories using inefficient, environmentally unfriendly technology can exist if market forces regulate the sector as claimed by China. Given this, it is inevitable that the United States Government and steel industry remain concerned that China's steel industry is subsidized.

¶20. (SBU) DG Wang said in response that the Chinese Government does not have the money to subsidize the steel industry. China is a market economy, albeit a market economy that operates differently than the United States model. DG Wang reiterated that the United States should not make assumptions about the Chinese economy using its own experience. The United States and other countries should not assume economic actions taken by China are designed to harm the

United States or other countries. Finally, DG Wang encouraged the United States to have patience with China as it reforms its steel sector. China so far does not possess the same well-established labor and social security mechanisms that have allowed the United States to effectively reform its steel sector in the past.

¶21. (SBU) AUSTR Stratford and DAS Estrada stated that the next round of the Sino-United States Steel Dialogue should take place concomitant with the next Joint Commission on Commerce and Trade (JCCT) meeting in 2007. The talks should be held in Washington, D.C. given that the first two rounds have been held in Beijing. AUSTR Stratford stated that the presentations made by the United States delegation will be shared electronically in their entirety with the Chinese Government. (Note: The United States delegation provided the presentations to MOFCOM on October 23, 2006. End Note.)

¶22. (SBU) DG Wang concurred with the timing of the next round of talks, and indicated that he would check with other Chinese Government and industry participants on holding the next round in the United States. MOFCOM will provide the United States Government with a document clearly outlining the various VAT export rebates applicable to Chinese steel products. Additionally, MOFCOM will send the United States Government collected Chinese Government and industry comments regarding the North American industry association papers detailing China's subsidies and other government intervention to its steel industry and another industry paper submitted to USTR regarding China's WTO compliance. DG Wang will ask the NDRC to share a copy of its presentation on China's Steel Policy with the United States delegation. DG Wang also will encourage the NDRC to

share any list it develops on specific closures of Chinese steel mills with the United States Government.

ATTENDEES AND CLEARANCE

¶23. (U) List of United States Attendees:

--Tim Stratford, Assistant USTR for China
--Jamie Estrada, Deputy Assistant Secretary for Manufacturing, Commerce Department
--Joe Spetrini, Deputy Assistant Secretary for Policy and Negotiations, Commerce Department
--Jean Kemp, Director, Steel Trade Policy, USTR
--Charlie Bell, International Trade Specialist, Commerce Department
--Brian Jones, Economic Officer, Embassy Beijing
--Sarah Ellerman, Commercial Officer, Embassy Beijing
--Representatives from the Steel Manufacturers Association, the American Iron and Steel Institute, IPSCO, Nucor and U.S. Steel.

¶24. (U) List of Chinese Attendees:

--Director General Wang Shouwen, Bureau of Fair Trade, Ministry of Commerce (MOFCOM)
-- Liu Danyang, Director, Bureau of Fair Trade, MOFCOM
--Wei Wei, Bureau of Fair Trade, MOFCOM
--Rong Min, Deputy Division Chief, Department of Treaty and Law, MOFCOM
--Duan Dingjian, Deputy Division Chief, Department of Planning & Finance, MOFCOM
--Wang Youli, Deputy Division Chief, Department of American & Oceania Affairs, MOFCOM
--Fu Jingjie, Department of WTO Affairs, MOFCOM
--Sun Zhihong, Director, Department of Foreign Trade, MOFCOM
--Wang Deyang, Deputy Division Chief, Department of Mechanic, Electronic & High Tech. Industry, MOFCOM
--Che Hui, Division Chief, Bureau of Industry Injury Investigation, MOFCOM
--Lu Jiang, Deputy Division Chief, Office of Representative for Int'l Trade Negotiation, MOFCOM
--Luo Tiejun, Director, Department of Industry, NDRC
--Zhang Xie, Department of Economics and Trade, NDRC
--Liu Zhimei, Deputy Secretary-General, China Chamber of Commerce of

Metal, Minerals & Chemicals Importers & Exporters
--Dong Zhihong, Director, China Iron and Steel Association
--Representatives from Bao Steel, An Steel, Capital Steel, Wuhan Steel, Sha Steel, SinoSteel, China Minmetals and SinoChem

¶25. (U) This cable has been cleared by the United States Government delegation.